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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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Public Record

UNION PACIFIC'S
<u>COMMENTS AND INITIAL PROPOSALS</u>

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May 16, 2000

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COMMENTS AND INITIAL PROPOSALS

Union Pacific Corporation and Union Pacific Railroad Company (collectively "UP") appreciate the opportunity to offer comments in response to the Board's Advance Notice of Proposed Rulemaking served March 31, 2000 (the "ANPR").

As the comments in Public Views on Major Rail Consolidations establish, the Board's policies and rules regarding Class I rail mergers[1] must be revised. The Board's current rules are based on the outdated assumption that the railroad industry suffers from excess capacity -- a condition that no longer exists.[2] The shipping community's broad hostility toward additional mergers under current policies and regulations underscores the need for this revision.

UP questions whether additional Class I consolidations will ever be in the public interest, even though mergers have provided important benefits in the past.

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1 We use the term "merger" to refer to mergers and other forms of consolidation and changes of control involving Class I rail carriers that are treated as "major transactions" under the Board's merger rules.

2 As UP urged in its Comments in Ex Parte No. 582, the Board should strike from its rules the outdated first two sentences of 49 U.S.C. § 1180.1(a).

They helped eliminate the excess capacity that pre-Staggers Act regulation had forced the railroads to maintain. They combined traffic flows onto fewer routes and via fewer interchanges, allowing railroads to take advantage of economies of density. They helped the railroads achieve major productivity gains, many of which were passed along to shippers in the form of lower rates. And they provided homes for financially weak railroads that had little or no prospect of remaining viable on their own, including the Western Pacific, M-K-T, and Southern Pacific railroads.

Today the Board and stakeholders in rail transportation confront new realities that require a paradigm shift in the way we think about these mergers. The process of eliminating large-scale excess capacity in the rail industry is mostly complete. With far fewer railroads interacting, the opportunities for cooperation to achieve benefits traditionally ascribed to mergers are brighter than ever. For example, studies suggest that alliances are both increasing popular in American business and provide better returns on investment than mergers. Technology is about to alter this 165-year-old industry. More than one railroad has said publicly that e-commerce will "revolutionize" the railroad industry. Most important, additional Class I mergers would likely result in only two major railroads north of the Mexican border.

UP encourages the Board to develop policies and rules that are appropriate for considering merger proposals in this new environment. The Board should evaluate the impact of and need for any additional Class I mergers on the assumption that any such merger is part of an "end game" resulting in transcontinental mergers and only two major railroads in North America. It should condition any mergers it approves in a manner that protects the public interest and shipper interests under that industry structure. Only by adopting this perspective can the Board develop realistic and consistent public policies.

UP will propose and discuss several potential rule changes designed to respond to some of the concerns its customers voiced in the Ex Parte No. 582 proceeding and to adapt the Board's rules to the prospect of transcontinental and trans-border mergers. Our proposals are detailed but should be considered as only initial concepts for further discussion. We expect to revise or reconsider them in response to comments from other parties.

UP discusses its proposals in the order of the topics listed in the ANPR, not in order of their importance.

I. Downstream Effects

When Burlington Northern Santa Fe and Canadian National notified the Board of their consolidation plans, the Board quickly recognized that their transaction would lead to "downstream" effects, including responsive merger applications likely to yield only two remaining North American rail systems. It promptly suspended the "one case at a time" rule set forth in 49 C.F.R. § 1180.1(g). Under the Board's ruling, parties in a BNSF/CN proceeding would have been expected to consider downstream effects.

UP believes the Board acted wisely, and it encourages the Board to impose the same requirements on all proposed Class I merger proposals. Any combination among the six largest remaining railroads in North America would be part of and would drive what many parties at the Board's public hearing described as the "end game" in rail consolidations. Before approving any additional Class I merger, the Board should consider whether the "end game" is in the public interest. This is the overriding public policy question before the Board.

UP offers two specific proposals. First, although we believe that there are still too many possible permutations to expect parties to address every imaginable combination of Class I carriers and that such an exercise would involve too much speculation, it is not too early to require parties to address in future applications whether a two-railroad North American rail system would be in the public interest. For example, applicants and other parties should address whether a single railroad serving Florida, the Northeast, Western Canada, and California would be manageable and responsive to its shippers. Second, to provide a more realistic analysis of proposals that reach the Board in the same time frame, the Board should announce now that it may consider such proposals in a single, combined proceeding.

UP recommends that the Board replace 49 C.F.R. 1180.1(g) with the following provisions:

> (g) *Downstream effects.*
>
> (1) Applicants proposing a major transaction must evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads. Applicants need not identify specific combinations, but should evaluate the implications of an industry structure consisting of two major railroads.
>
> (2) The Board may, on its own motion or on request of an interested party, consolidate for hearing and decision any application proposing a major transaction filed before the date set for the filing of inconsistent applications in another pending proceeding arising out of another application proposing a major transaction.

II. Maintaining Safe Operations

UP is satisfied that current safety requirements in connection with Class I mergers adequately protect the public interest. The Board's safety compliance programs, developed in conjunction with the Federal Railroad Administration, appear to be effective in ensuring that mergers are implemented safely. The Board should take equal care to ensure that any conditions applied to future Class I mergers can be implemented with similar attention to safety.

III. Safeguarding Rail Service

Service failures following recent major mergers are a primary cause of shipper disaffection with railroads and rail mergers. The Ex Parte No. 582 record rings with shipper complaints about promises unfulfilled and service that declined after mergers. We expect all railroads to propose more stringent measures to prevent future mergers from causing service to decline. Like other railroads, UP proposes more comprehensive implementation planning.

UP believes that railroads proposing future mergers should also accept greater responsibility for effects of their mergers by providing remedies for any significant service deterioration. We believe that the Board has the power to condition mergers in the public interest by establishing an expedited procedure for customers to obtain either temporary substitute service or recovery of substitute transportation costs. Following its 1997-98 service crisis, UP paid hundreds of millions of dollars in such costs to its customers, well beyond its likely liability in the courts.

Remedies must be based on quantifiable and detailed performance data that measure railroad performance in a way that is meaningful to individual shippers. Shippers and the railroads that serve them should be able to compare service before and after a consolidation using consistent measurements.[3] UP proposes that applicants create and maintain databases showing both on-line transit times and on-line cycle times for individual shipments, as well as the extent of variability in each measurement.

UP would also be interested in developing performance measurements for car supply, but we have not been able to identify a way to solve several problems. During car shortages, when the parties most need accurate data, some shippers order more cars than they need to protect their minimum requirements, thereby distorting the railroad's performance. Also, a railroad's ability to satisfy a car order depends on how far in advance the shipper orders the car. Railroads will more frequently fail to fill requests for cars on the same day than requests for cars in three days. UP would be interested in suggestions regarding this performance measurement.

The applicants should be required to develop these data for the base year used in their merger application and compile comparable data throughout the merger implementation period. They should retain all such data throughout the implementation period.

UP proposes an expedited Board procedure to provide effective remedies if, despite all reasonable precautions, service declines significantly after a merger. Customers could request either access by another carrier during the service failure or compensation for reasonable additional transportation costs, such as the cost of moving products by truck.

UP proposes the following addition to 49 C.F.R. § 1180.8:

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3 During its service crisis, UP encountered great difficulty in reconciling its performance data with shipper records. Our proposal solves that problem by requiring comparable data for pre-merger and post-merger periods.

(c) (1) For *major* transactions, provide a detailed implementation plan (exhibit __) explaining how the consolidated entity will perform all of the important actions necessary to implement the consolidation and how it will provide adequate capacity for post-consolidation service. These actions should include at least the following:

- (i) labor agreement consolidations;
- (ii) computer-system integration;
- (iii) significant personnel reductions;
- (iv) major reroutes and extended hauls;
- (v) capacity expansions and track upgrades;
- (vi) acquisition of locomotives and freight cars; and
- (vii) facility consolidations and expansions.

Applicants should state the major assumptions underlying the implementation plan. The implementation plan should also set forth the schedule on which public benefits will be achieved. Unlike the operating plan, which is based only on the incremental effects of the consolidation, the implementation plan should accommodate reasonably expected changes in traffic volume that would occur without the consolidation during the implementation period.

(2) The implementation plan should give shippers warning of critical time periods during which service might be affected by major changes, such as computer-system integration. For each major change, the applicants should describe contingency plans and procedures to recover from any service problems that might arise. After consolidation, the combined carrier must update the implementation plan, including the timing of the actions listed in (c)(1)(i)-(vii) above, in quarterly reports to the Board until all of the important implementation actions have been completed. The combined carrier must also transmit notices to potentially affected shippers and other carriers not less than 30 days in advance of implementation actions that might cause disruption, unless circumstances prevent issuing such notices.

UP also proposes the following new section of Part 1180:

1180._ Remedies for service deterioration as a result of consolidation

(a) For the base year, applicants in a *major* transaction must prepare and maintain a database from which it is possible to obtain pre-consolidation (1) transit times and variability of transit times for all shipments; (2) cycle times and variability of cycle times for all applicable shipments; and (3) [supply of empty cars] (collectively, "Service Measurements"). If the consolidation is approved, the combined carrier must maintain this database for five years after the effective date of the Board's decision approving the consolidation, and provide Service Measurements to affected shippers or Class III rail carriers that have a legitimate need for the information in order to demonstrate service deterioration.

(b) The following provisions apply for a period of five years after the effective date of the Board's decision approving the consolidation:

(1) If a shipper (not a third-party beneficiary) or Class III rail carrier that has shipped more than 100 cars over 12 months in a corridor can show that a Service Measurement for its traffic has deteriorated by an average of more than 50 percent from pre-consolidation levels for more than 60 consecutive days, it may give the consolidated carrier written notice asking the railroad to cure service within 60 days from the date of receipt of the notice and to provide historical and current Service Measurements for the affected traffic.

(2) If the carrier is unable to restore service to the 50 percent level by the end of the 60-day cure period, the shipper or Class III rail carrier may file a service complaint with the Board seeking a remedy for inadequate service. To file a service complaint, the shipper or Class III rail carrier must show that the carrier's service, as measured by any of the Service Measurements, deteriorated by an average of more than 50 percent from the base period for 120 or more consecutive days (through the cure period), that it cooperated with the carrier in efforts to restore service, and that it has incurred increased transportation costs as a result of the deteriorated service. Unless the carrier can establish in a reply to be filed within ten days after receipt of the service complaint (x) that the service decline is attributable to factors other than implementation of the consolidation or (y) that the complaining party did not reasonably cooperate with remediation efforts, the Board may grant either of the following remedies within 30 days after the complaint is filed:

(i) temporary access by reciprocal switching or trackage rights (including, if necessary, temporary trackage rights over other carriers) to the complainant's facility, if the Board concludes that access will result in improved service to the shipper and will not adversely affect service to other shippers or further degrade the operations of the consolidated carrier; or

(ii) reimbursement of incremental transportation costs that could not reasonably be mitigated and that were incurred by the complainant or, if complainant is a Class III rail carrier, by shippers located on that carrier.

(3) Pursuant to 49 U.S.C. § 11123, the Board will reconsider the need for the service remedy after 30 days, and the service remedy will automatically expire, if not previously terminated, after 270 days. The consolidated railroad may at any time petition for termination of a service remedy on the ground that service has been restored to the 50 percent level.

(4) If the Board grants temporary access and the railroads cannot agree on compensation, the Board will apply compensation standards under 49 U.S.C. §§ 11102 and 11123.

(5) The entity obtaining access must be a rail carrier with operating authority from the Board, and the Board must determine that such carrier can operate safely to address the service problem.

(6) Remedies are available only to shippers lacking existing rail alternatives; provided, however, that the complainant may seek compensation if it can show that the other serving carriers are disabled by the merger-related service problem.

(7) If necessary to effectuate the temporary access remedy, the Board may temporarily suspend a shipper's contractual duty to ship specified volumes of traffic under rail service contracts with the consolidated carrier. The suspension would apply only for the time period necessary to alleviate the service problem.

IV. Promoting and Enhancing Competition

The Board seeks comment on various mechanisms by which rail merger policy might be used to promote and enhance, rather than simply preserve, competition. Most of these mechanisms address the effects of railroad mergers on so-called "bottleneck segments," which are rail segments that connect shipper facilities exclusively served by one carrier with gateways where that carrier connects with other carriers.[4]

UP does not favor using the Board's jurisdiction over rail mergers to alter the competitive structure of the rail industry other than to address the effects of a merger. UP recognizes, however, that most shippers do not want railroad mergers to affect their

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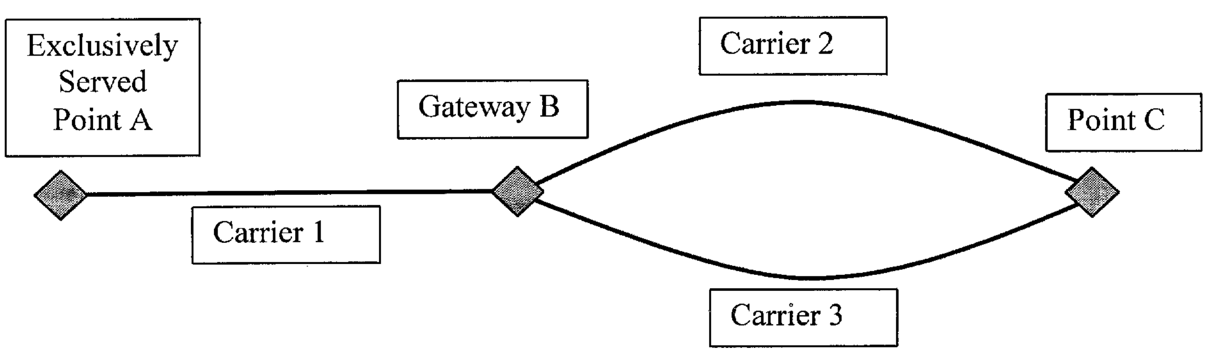
[4] As the Board's March 31, 2000 decision notes, it is well established that the ICCTA generally does not require rail carriers to establish separately challengeable rates for bottleneck segments. The Board's so-called "Bottleneck" rate decisions clarify the specific circumstances under which carriers may be required to establish, and shippers permitted to challenge, bottleneck rates. See Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, clarified in Decision served Apr. 30, 1997, aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir.), cert. denied, 120 S. Ct. 372 (1999); Union Pacific R.R. v. STB, 202 F.3d 337 (D.C. Cir., 2000).

future opportunities to use established interline routing options. Shippers also do not want mergers either to create new bottlenecks or expand existing bottlenecks. Some shippers are concerned that combinations may eliminate competitive routing options that were previously available for the portion of the overall movement between the gateway and either the origin or destination of the traffic – in effect extending the bottleneck segment. Some shippers are also concerned that, where carriers have established separately challengeable bottleneck rates, a combination with another carrier capable of completing the movement could extinguish the shipper's ability to challenge the bottleneck rate.

UP does not share the view of many shippers that end-to-end mergers generally have anticompetitive vertical effects, and the Board must retain the basic economic and legal principles that guided its Bottleneck decisions. Nevertheless, if the nation's rail system is to be restructured into two transcontinental systems, the Board should take action to keep traditional gateways open. Vague assurances that gateways will stay open are not sufficient because there are too many ways to close them commercially.

UP proposes that the Board modify its rules to require combining carriers to make available at a shipper's request separately challengeable bottleneck rates between exclusively served facilities on their system and the predominant pre-merger gateway for the applicable traffic from those facilities. In the classic "rat-tail" diagram set forth below, if



Carriers 1 and 2 combined, they would be obligated, at the shipper's request, to establish a rate for the "bottleneck" segment between exclusively served Point A and Gateway B. This would preserve the shipper's pre-merger options, because the shipper could combine the A-to-B rate with rates offered by Carrier 3 to complete the movement from origin (Point A) to destination (Point C) and, if necessary, challenge the reasonableness of the A-to-B rate. In fact, such a condition would go somewhat beyond merely preserving the exclusively served shipper's routing options. In some cases, as where the traffic is now moving under joint or proportional rates, the reasonableness of the rate between Point A and Gateway B is not separately challengeable today.

The following specific language for a new section in Part 1180 would implement the proposal outlined above:

1180.__ Preservation of gateways and rate challenge options.

(a) A Class I rail carrier participating as a Primary Applicant in a *major* transaction approved by the Board (a "Participating Carrier") shall, upon request of an affected shipper, establish a rate for transportation (a "Segment Rate") applicable to traffic as to which no Participating Carrier served both the origin and destination of the traffic prior to consummation of the transaction (the "Subject Traffic"), between:

(1) any Exclusively Served Shipper Facility, which means any shipper facility (i) other than an automotive distribution ramp, intermodal facility, or transload facility (ii) that is located at any point on the carrier's system served exclusively by that carrier and no other rail carrier (either directly or via reciprocal switching, joint facility or other service arrangement) (iii) where traffic originated or terminated during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction; and

(2) the Pre-Transaction Gateway, which means the point of interchange, if one exists, that during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, was (i) an actual interchange between the Participating Carrier and two or more other rail carriers, one of which was another Class I carrier participating in the transaction as a Primary Applicant, (ii) the interchange point most frequently used to move the Subject Traffic (or comparable traffic if the rate

would apply to new traffic) between the Exclusively Served Shipper Facility and the origin or destination of the traffic, and (iii) used by at least 100 cars of traffic originating or terminating at the Exclusively Served Shipper Facility.

(b) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to combine the Segment Rate with a rate or rates offered by a carrier other than the Participating Carrier for movement between the Pre-Transaction Gateway and the origin or destination of the Subject Traffic.

(c) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to challenge the Segment Rate as unreasonably high to the same extent and under the same standards as applicable to rate reasonableness challenges under 49 U.S.C. §§ 10701 and 10707. In determining whether the Participating Carrier is "market dominant," the Board will examine whether there is an absence of effective competition on the entire origin-to-destination route, rather than on the segment between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway.

(d) A shipper facility served exclusively by a Class III rail carrier that is incapable of interchanging traffic with any carrier other than the Participating Carrier, or that is obligated by contract to interchange the majority of its traffic with the Participating Carrier, shall be treated as a facility served exclusively by the Participating Carrier for purposes of this rule. If the Participating Carrier lacks authority to establish a Segment Rate between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway, it shall instead establish a Segment Rate between the point of interchange with the Class III carrier and the Pre-Transaction Gateway.

(e) The obligation to establish a Segment Rate shall also apply to any rail carrier (a "Trackage Rights Carrier") that receives trackage rights or other access to the lines of a Participating Carrier as a result of settlement agreements with the Primary Applicants or conditions imposed on the Primary Applicants by the Board. The Trackage Rights Carrier shall be obligated to establish a Segment Rate pursuant to subparts (a)-(d) above only (1) for traffic capable of being handled using the rights or other access granted to the Trackage Rights Carrier and (2) between Exclusively Served Shipper Facilities located on the Trackage Rights Carrier's system as it existed prior to the transaction and the applicable Pre-Transaction Gateway, if any, where such traffic was interchanged, during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, with the Participating Carrier over whose lines access was granted.

Such a rule would preserve shippers' pre-merger routing and rate challenge options in a straightforward manner that would not unduly constrain the ability of the combined carrier to achieve efficiencies associated with the combination. Because it would make use of existing mechanisms for challenging rates, the merging carriers would be able to estimate the costs of this condition in advance. And the condition would ensure that the major pre-transaction gateways would remain open.[5]

This approach is preferable to the options suggested by the Board:

- The Board's contract option would require the shipper to carry the burden of negotiating an agreement with the non-merging carrier on rates and all other attributes of the transportation. That commercial agreement might not be reached.

- The Board's through route alternative would require the merged carrier and connecting carriers to agree. Again, they might not reach agreement.

- The Board's reciprocal switching and trackage rights proposals would run afoul of the fundamental policy basis for the Board's Bottleneck decisions, which affirmed bottleneck carriers' traditional routing discretion and statutorily-recognized right to select their long-hauls.[6] Those proposals would go far beyond what is needed to offset effects of the merger.

No new rule should require the merged carrier to short-haul itself, depriving the carriers of the returns upon which they depend to attract capital, reinvest in their rail networks, and maintain and improve service.

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5 Our proposed rule clarifies that the existence of transportation alternatives providing effective competition will be evaluated with respect to the entire movement from origin to destination, which is the transportation service of interest to the shipper. This will avoid the anomalous outcomes that would result were market dominance determinations based on competition for the bottleneck segment only, for example where intermodal competition between origin and destination provides a competitive constraint on rail rates but does not exist at a remote rail gateway where there is no reason at all for competition to exist. See, e.g., STB Docket No. 42038, Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., Decision served July 8, 1999 (ignoring rail-truck alternative between coal mine and utility because there was no evidence of transportation competition at interchange point).

6 Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, pp. 4-11.

Our rule is also far superior to the long-discredited "DT&I" conditions. Those conditions imposed draconian and inefficient requirements to allow routing over all possible gateways and required rate and service parity regardless of the relative efficiencies of various routes. Any such requirement would create significant impediments to efficiency.

UP's proposed rule would supplement existing precedent governing Board analysis of the potential vertical competitive effects of proposed rail combinations. The Board has not established a hard-and-fast rule that end-to-end combinations can never have anticompetitive effects. Rather, the Board's so-called "one-lump" theory establishes a presumption that end-to-end mergers do not have such effects. The presumption can be rebutted, and shippers can seek additional remedies. See, e.g., Finance Docket No. 32549, BN/Santa Fe, Decision No. 38, served Aug. 23, 1995, p. 71, aff'd, Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997).

V. Shortline and Regional Railroad Issues

All of the concerns expressed by shortline (Class III) and regional (Class II) railroads (collectively, "smaller railroads") can be addressed by the Board's general rules addressing competition and service issues. The service and bottleneck rate protections set forth in other new rules that UP has proposed would provide significant protections for Class III railroads and the shippers they serve. Additional rules specifically addressing shortline issues are not needed.

In particular, concerns regarding the appropriateness of contractual limits on interchange (sometimes called "paper barriers") are not the proper subject of general merger rules. The underlying contractual obligations did not arise from mergers and often are unaffected by mergers, particularly on UP. Issues relating to such contractual provisions were addressed in Ex Parte No. 575, Review of Rail Access and Competition Issues, and they are the subject of a comprehensive industry agreement negotiated between the Association of American Railroads ("AAR"), on behalf of Class I railroads, and the American Short Line and Regional Railroad Association, on behalf of smaller railroads. AAR has formally invited ASLRA to negotiate regarding that agreement. These issues have also been addressed in individual merger cases on a case-by-case basis.[7]

VI. Employee Issues

UP joins in the Comments of the National Railway Labor Conference.

VII. "Three-to-Two" Issues

UP disfavors any hard-and-fast assumption that anticompetitive effects arise only when the number of rail carrier alternatives drops from two to one. UP believes that the Board should clarify that it will not constrain its analysis of the competitive effects of future transactions in this manner. In past cases, the Board has recognized the potential competitive effects of proposed combinations that reduce the number of rail carrier alternatives from three to two, such as where the combination involves the shippers' two most efficient alternatives.[8] The Board can assess the competitive effects of any proposed transaction only by considering the individual circumstances of each situation.

The Board should therefore consider the following new rule, which could be inserted at the end of 49 C.F.R. § 1180.1(c)(2)(i):

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7 See also Finance Docket No. 33388, CSX/NS/Conrail, Decision No. 89, served July 23, 1998, p. 77.

8 See, e.g., Finance Docket No. 32760, UP/SP, Decision No. 63, served Dec. 4, 1996 (explaining the need for conditions to preserve competitive options for shippers at Lake Charles, Louisiana, served pre-merger by UP, SP and KCS, because of circuity in KCS's route structure).

> The Board will evaluate on a case-by-case basis all claims that a proposed transaction would adversely affect competition by reducing the number of rail carrier alternatives serving an individual shipping point, an origin-destination corridor, or some other properly-defined transportation market. In evaluating such claims, the Board will not apply any rigid numerical standard based on the number of rail carriers serving the market before and after the transaction. Rather, the Board will examine all of the circumstances relevant to the competitive effects of the transaction, including such factors as the nature of the transportation service at issue; the effectiveness of the competition provided by each of the rail carriers serving the corridor, point or market; constraints on rail rates from intermodal, geographic or product competition; and the transaction's effects on the strength of competition among the serving rail carriers.

VIII. Merger-Related Public Interest Benefits

UP recommends that the Board establish a higher threshold for claims of merger benefits. The Board's existing rules indicate that it will "consider whether the benefits claimed by the applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public." 49 C.F.R. § 1180.1(c). In practice, however, the Board has been reluctant to find that particular claimed merger benefits could be achieved by means other than merger.[9] Recent changes in the structure of Class I railroads, advances in technology, and various innovations in cooperative relationships among rail carriers have made it much more likely that categories of public benefits historically associated with railroad combinations can be achieved via other means. These include:

- Alliances among connecting carriers, such as the KCS-CN-IC alliance;

[9] See, e.g., Finance Docket No. 33556, CN/IC, Decision No. 37, served May 25, 1999, pp. 46-49; Finance Docket No. 32760, UP/SP, Decision No. 44, served Aug. 12, 1996, pp. 109-13.

- Industry initiatives, such as AAR's "Interline Service Management" program, which expects to resolve remaining data exchange issues this summer;

- Operational coordinations, such as CN and CP's recent agreement on directional running in British Columbia and the efforts currently underway to streamline operations in the congested Chicago terminal;

- Service initiatives, such as the recently announced NS-BNSF transcontinental intermodal trains; and

- Potentially revolutionary changes in railroading as a result of "business-to-business" e-commerce.

All hold the potential for achieving many of the types of public benefits that historically have been associated with railroad combinations.

Mergers should not be credited with benefits that are practicably achievable through other means that would not cause irreversible changes in the structure of the railroad industry. Indeed, mergers may impair benefits achievable through alternative arrangements. For example, the KCS-CN-IC alliance probably will be lost if BNSF and CN merge.[10] Accordingly, the Board should modify its rules to clarify that it will treat as public benefits only those benefits that can practicably be achieved only through mergers.

UP proposes replacing the last sentence of 49 C.F.R. § 1180.1(c), immediately preceding sub-part (1), with the following:

> The Board will treat as public benefits only those improvements in cost, efficiency, service, competitiveness, or other benefits that applicants demonstrate are incremental to the benefits that could practicably be achieved through means other than a major transaction. The Board will also consider whether, as a result of the applicants' pursuit of the proposed transaction, any improvements in cost, efficiency, service,

[10] At the Ex Parte No. 582 hearing, Michael R. Haverty, President and Chief Executive Officer of the Kansas City Southern Railway predicted that, if BNSF and CN combine, "We do not feel that long term the CN-IC-KCS marketing alliance is going to survive."

> competitiveness, or other benefits that would likely be achieved without the transaction would be reduced or lost as a result of the proposed transaction.

IX. Cross-Border Issues

UP believes that the Board should clarify two aspects of its rules as they relate to potential combinations involving non-U.S. carriers.

First, the Board's rules should explicitly acknowledge the extensive relationships among all aspects of the North American rail network by requiring, in the case of a proposed combination involving a carrier within the Board's jurisdiction that has foreign operations, that applicants submit with their application the same information for the foreign service as would be required if the participating carriers operated wholly within the United States. The Board cannot effectively carry out its obligation to evaluate whether a proposed Class I combination is in the national public interest unless it is able to evaluate all aspects of a transaction that affect the United States.

Because of the network characteristics of the railroad industry, changes brought about by a combination that directly affect one part of a railroad system can have significant indirect effects on other parts of the system or, indeed, on the entire North American rail network. This interrelationship was borne out clearly in connection with UP's 1997-1998 service difficulties, when congestion in the Houston area led "to a lengthy and damaging service breakdown dramatically affecting rail transport throughout the West."[11]

[11] Finance Docket No. 32760 (Sub-No. 26), UP/SP Houston/Gulf Coast Oversight, Decision No. 10, served Dec. 21, 1998, p. 6.

The same is true with respect to the competitive impacts of a proposed transaction. Because huge volumes of Canadian-originating rail traffic move into the U.S.,[12] transactions that affect competitive alternatives in one part of the continent – in one province of Canada, for example – may have an impact on U.S. interests.

Given these interrelationships among all parts of the North American rail network, the Board and other interested parties participating in a merger proceeding cannot be assured of having access to all the information needed to protect the public interest unless the applicants treat their proposed transaction, for purposes of the analysis to be performed by the Board, as if it were occurring entirely within the United States. Applicants should be required to submit to the Board a system-wide operating plan and a system-wide implementation plan. Applicants should similarly be required to address in their application all the competitive effects of their proposed combination, including effects that might seemingly involve competition outside the United States. Applicants should also address the potential effects of public policies in the foreign jurisdiction on U.S. rail service and viability.[13]

UP recommends that the Board's rules be clarified by adding the following new subsection 1180.6(d):

> In major transactions involving carriers with foreign operations, the information required to be included in the application by this section and sections 1180.7, 1180.8, and 1180.9 shall address the entire transaction and all of its

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12 For example, more than 80 percent of British Columbia Railway's traffic flows into the United States.

13 For example, the Canadian government recently ordered CN and CP to reduce grain rates by 18 percent. If applied to all traffic, such policies could impair the viability of the Canadian portion of a combined rail system.

> impacts, including competitive impacts, operating changes and financial effects outside the United States.

Second, it is well established that the Board has broad power to impose conditions designed to mitigate adverse effects of the proposed transaction by indirect means if necessary. For example, the Board can require applicants to enter into agreements with third parties that remedy adverse consequences of their proposed transaction even where the Board itself could not impose upon the applicants the relief embodied in the agreement.[14] The Board's rules should make clear that the Board will impose conditions to remedy potential adverse consequences of transactions involving foreign operations, even where jurisdictional limits on the Board's authority may preclude the Board from granting relief directly. If necessary to make such conditions enforceable by the Board, the Board could require that applicants consent to Board jurisdiction with respect to disputes concerning compensation or other aspects of the conditions the Board imposes.[15]

UP proposes that the Board clarify its rules in this regard by adding the following language to the end of section 1180.1(d)(1):

> In *major* transactions involving carriers with foreign operations, the Board may impose conditions to ameliorate potential adverse effects arising outside the United States. The Board may, for example, as a condition to approving the application, require applicants to enter into legally enforceable private agreements that would remedy potential harms.

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14 See, e.g., Finance Docket No. 32760, UP/SP, Decision No. 44, served Aug. 12, 1996, p.146 (requiring UP, as condition of consummating proposed acquisition of SP, to modify contracts with shippers at 2-to-1 points to allow BNSF access to at least 50% of volume).

15 Agreements entered into to carry out conditions imposed by the Board are routinely enforced by the Board notwithstanding that similar agreements among carriers that do not stem from Board-imposed conditions would be outside the Board's jurisdiction. Canadian Pac. Ltd. v. United States, 379 F. Supp. 128, 133 n.12 (D.D.C. 1974).

CONCLUSION

UP believes that this proceeding is among the most important to come before the Board since the Staggers Act. The rules and policies established here will shape the future structure of the railroad industry and may determine whether the industry grows or atrophies. UP will continue to participate with those high stakes in mind.

Respectfully submitted,

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May 16, 2000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 16th day of May, 2000, a copy of the foregoing "Union Pacific's Comments and Initial Proposals" was served by regular mail, postage pre-paid, or a more expeditious manner of delivery on all parties and non-parties of record to this proceeding.

J. Michael Hemmer

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